


Internal Revenue Service
memorandum

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Br3:RChewning

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to: Ray Collins--District Counsel SW:DAL

from: Carol Doran Klein
Chief, Branch 3 CC:INTL:Br3 

subject: Potential Problem with Regs. 1.907 (e)-1 (a) (4)

This is in reference to Brian K. Hom's memorandum of May 14, 1985, concerning the "Potential Problem with Regs. 1.907 (e)-1 (a) (4)."

ISSUE

In dividing the carryover of unused foreign tax between unused FORI tax and unused non-oil tax (NORI tax) from years ending before January 1, 1975, under regulation § 1.907 (e)-1 (a) (4), whether the equation used to divide the carryover should take into account NORI if NORI is a net loss.

CONCLUSION

We conclude that in applying the pro ration equation set forth in regulation § 1.907 (e)-1 (a) (4) that NORI should not be taken into account if it is a net loss. To do otherwise would in certain circumstances apportion part of the unused foreign tax paid on what was clearly FORI to NORI. This would be contrary to Congressional intent that FORI tax offset only U.S. tax on FORI income.

DISCUSSION

Section 907 (e) (1) (B) as enacted by the Tax Reduction Act of 1975 provided that the carryover of tax from a taxable year ending before January 1, 1975, to a taxable year ending after December 31, 1975, shall be divided into a foreign oil related carryover and another carryover on the basis of the proportionate share of the foreign oil related income, or the other taxable income, as the case may be, of the total taxable income taken into account in computing the amount of the carryover. The regulations at § 1.907 (e)-1 (a) (4) (i) in applying this

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provision provide that the following equation should be used to determine the FORI tax portion of the carryover for each year of origin:

$$\text{Unused foreign tax} \times \frac{\text{FORI}}{\text{Total foreign income}} = \text{Unused FORI tax}$$

The unused NORI tax is the remainder of the unused foreign tax. All of the examples in the regulations illustrate application of the equation in situations where the taxpayer had net income from NORI on which the taxpayer paid tax to a foreign country. None of the examples illustrate how the equation should be applied in the situation addressed in this memorandum where [REDACTED] had a net NORI loss and did not pay any tax to a foreign country on that net NORI loss. There is no indication in the regulation file that the drafters of § 1.907 (e)-1 (a) (4) considered this circumstance.

Since the regulations do not illustrate how the equation is to be applied in the [REDACTED] situation, they must be interpreted in light of the intent of the Congress that enacted section 907 (e) (1) (B) in 1975 that foreign taxes on FORI are to be credited only against U.S. taxes on FORI. Conf. Rept. 94-120, 1975-1 C.B. 631. This Congressional intent will only be met if net NORI losses are not reflected in the equation.

In situations where a taxpayer incurs a net NORI loss, Congressional intent will be met if the unused foreign tax is apportioned on the basis of what percentage FORI is of the total taxable income of the taxpayer. Since there is a net NORI loss, FORI will equal 100% of the total taxable income. Accordingly, all of the unused foreign tax will be apportioned to FORI. This analysis is supported by the language of section 907 (e) (1) (B) flush, as in effect prior to TEFRA, which provided that the carryover of tax will be divided on the basis of the proportionate share of FORI (or other taxable income) of the total taxable income. This proportionate share may be illustrated as follows:

FORI: Total taxable income
Tax attributable to FORI: Total tax